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NATIONAL MARINE FISHERIES SERVICE (NMFS)
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FVCCF UPDATE 97 - 1

MARCH 1997

AN INFORMATION RELEASE FOR FISHING VESSEL CAPITAL CONSTRUCTION FUND AGREEMENT HOLDERS

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REVISED DEPOSIT/WITHDRAWAL REPORT - NOAA FORM 34-82

The required annual report to NOAA Fisheries is revised; we hope it will be easier to use. Please take a few minutes to look at instructions on the form and on the accompanying sheet - even if you have reported for years. We now request that you summarize interest and dividends earned on the account on one line. You may drop pennies. Use a separate form for each depository account. Keep a copy of the form for your records. The report *must be* accompanied by a signed and complete copy of the agreement holder's tax return as filed with the IRS.

Please note important new information fields:

- Complete information on location of CCF funds on deposit
- Your address and telephone number
- Certifying signature information
- Answer Yes or No to both questions regarding current year activity. These questions appear below our mailing address in the upper left corner.

FORMAT CHANGE ON CCF CASE NUMBERS

Beginning immediately, all correspondence you receive will list your case number in a new format. Previously, the case number sequence was: CCF-S-42-75. The last two numbers designated the first year you entered the Agreement. The new format shows the case number as: CCF-S-75042. The first two numbers designate the first year you entered the Agreement. This enables us to use our database to produce forms and letters more easily. As before, the letter included in the case number designates the regional staff that is responsible for your Agreement.

SAFETY REGULATIONS FINALIZED

Effective 2/3/97, CCF regulations at 50 CFR 259.31(e) (copy enclosed) have been finalized to include qualified reconstruction withdrawals for acquisition and installation of equipment to increase general vessel safety and/or comply with the specific requirements established under the Commercial Fishing Industry Vessel Safety Act of 1988 and/or other laws and regulations that materially increase the safety of a fishing vessel.

This regulation allows the use of CCF funds to pay for fishing vessel safety-related projects without regard to the usual CCF reconstruction requirements: (1) the cost of the safety project; (2) whether the fishing vessel involved in the safety project had its useful life extended, its value increased, or was converted to a different fisheries use; and (3) conditional fishery requirements.

Safety projects, however, must be for an Agreement vessel and must otherwise be for the purchase of a capitalizable item. When tax deferred CCF funds are used, the tax basis of the safety equipment must be reduced. Examples of items that qualify for this special withdrawal treatment include life rafts, alarms, electronic navigation and communication equipment (including EPIRB) and fire control equipment.

Submit a Schedule B - Reconstruction form for approval prior to making withdrawals. Please be specific as to the types of safety equipment to be purchased. You may be asked to provide further information about the items prior to obtaining withdrawal approval. You may use the ratification procedures under 50 CFR 259.33(d) if you wish to proceed before receiving our written withdrawal permission. (See UPDATE 96-1, page 5.)

REVISED INTEREST RATE FOR NONQUALIFIED WITHDRAWALS MADE IN 1996

The interest rate applicable to 1996 nonqualified withdrawals was revised 10/28/96 to 6.93%. See specific instructions on tax return reporting of nonqualified withdrawals in IRS Publication 595. (Excerpted pages applicable to CCF are enclosed.)

NO TEMPORARY WITHDRAWALS

CCF regulations provide for only two types of withdrawals from your CCF account: **Qualified** or **Nonqualified**.

Qualified withdrawals are for the construction, acquisition, and reconstruction of your Agreement Schedule B objective vessel only. Withdrawals made from previously tax-deferred funds for any other purposes are **Nonqualified**, with no exceptions.

CHANGES TO BUSINESS STRUCTURE AFFECT CCF AGREEMENTS

If you entered your CCF Agreement as a **Sole proprietor** and you have since incorporated ownership of your vessel(s), you must notify us of this important change. The Agreement cannot continue as entered if you intend to continue making qualified withdrawals to pay on the vessel(s) or must meet future reconstruction requirements for the vessel that is now in corporate ownership status. You must open a new CCF Agreement for the corporation by filing a new CCF application. In the past, we have simply changed your original CCF Agreement into the name of your corporation. We will no longer do this. Please submit the new corporation application as soon as possible, or at least within 45 days of the tax due date for filing the corporation's first year tax return.

INSTALLMENT SALE OF A VESSEL

Special requirements must be met before the proceeds of an installment sale of an agreement vessel may be deposited. Consult with the CCF Program staff **before** selling an agreement vessel using an installment sale.

RECONSTRUCTION MAY BE REQUIRED

If CCF funds are used to acquire a used vessel, an additional objective **must be** accomplished before disposing of the vessel. Failure to do so will result in previous CCF withdrawals made for this vessel being

reclassified as nonqualified and trigger penalties and interest. If the vessel is 5 years old or less at the acquisition date you must either construct a new vessel within 10 years or reconstruct a current Schedule A vessel within 7 years. If the vessel is more than 5 years old, you must reconstruct that vessel within 7 years.

CCF Regulations under 50 CFR Part 259.31 specifically states that the sole consideration in allowing CCF funds to be used to acquire used vessels is to enable the party to accelerate accomplishment of the additional Schedule B construction or reconstruction. Failure to complete the required reconstruction may result in disqualification of previously qualified withdrawals and termination of your CCF Agreement.

CAUTION: If you are considering disposing of a vessel, please be very careful that all CCF requirements related to that vessel have been satisfied.

CONSIDERATIONS WHEN DISPOSING OF A VESSEL

If you dispose of a vessel that is part of your CCF Agreement, please notify us in writing of the vessel name and date of sale. This is needed so that we can remove this vessel as part of your Agreement.

- Before disposing of a vessel, you must be sure that you have met *all* CCF Regulations that affect that vessel. Specifically, if you used CCF funds to acquire a previously used vessel, you **must** reconstruct that vessel if it is greater than 5 years old at the date of acquisition. If it is 5 years old or less at the date of acquisition, you **must** either reconstruct a vessel or construct a new vessel. (See above. If you do not meet the additional requirements related to a used vessel acquisition, any withdrawals made for that vessel may be retroactively rendered nonqualified and penalties and interest may be assessed on the previous withdrawals. In addition, your CCF Agreement may be terminated for non-compliance.)
- Keep a copy of all paperwork related to this vessel including the Certificate of Documentation (CG-1270), Bill of Sale and proof of vessel's tax basis. These may be requested at a later date as we attempt to update your file.
- Consult with your tax advisor on proper treatment of vessel disposition. Generally, the gain is taxed as ordinary income and not capital gain because it is "section 1245" income - depreciation (or CCF) recapture. Many fishermen expect to pay tax at capital gains rates instead of ordinary income rates.
- If the Agreement holder no longer owns or leases any vessels used in the commercial fisheries of the United States, the maximum time allowed to place another vessel in service as a Schedule A vessel under this Agreement is three years. If a Schedule A vessel is not added within the three year period the Agreement will be terminated. Termination will trigger nonqualified withdrawal penalties and interest on funds remaining under the Agreement. See UPDATE 95-1, page 4 for additional information.

FULL DEPOSIT OF NET PROCEEDS REQUIRED TO DEFER GAIN

The minimum CCF deposit required to defer gain from a vessel's disposition can be more than the cash received. This happens when a vessel's mortgage is larger than the remaining tax basis. For an older vessel, this is often the case; the vessel was purchased with CCF funds and/or it is already fully depreciated.

For CCF purposes, the required Net Proceeds deposit may be thought of as the GREATER OF (A) cash received in the transaction, or (B) the *full realized taxable gain* for the year of sale.

(See example, next page.)

Example - A_{Net Proceeds} Calculation:

(A) Cash received in the transaction:			
Selling price (less expenses)	\$400,000		
(less) Debt on the vessel	(250,000)		
(equals) Cash received	\$150,000	=	(A)
(B) Calculation of Gain:			
Selling price	\$400,000		
(less) vessel's tax basis	(100,000)		
(equals) taxable gain realized	\$300,000	=	(B)

Since (B) exceeds (A), the *required* CCF deposit to defer payment of taxes on the sale would be \$300,000. Unless this full amount is deposited, no portion of the realized taxable income may be deferred. This is a harsh result when the deposit exceeds the cash in hand, but it is consistent with historic CCF policy and proposed regulations (the best guidance available on the joint intent of Commerce, Treasury, and Transportation).

CAUTION: Vessel sales and dispositions, Capital Construction Fund transactions, and the buy-back program each cause tax ramifications not expected by most taxpayers. We strongly recommend using the advisory services of a tax accountant experienced in these areas before disposing of a vessel.

REVIEW SCHEDULE B OBJECTIVES ANNUALLY

Review Schedule B objectives for your CCF Agreement annually. Check the following items:

- Depository balance does not exceed A_{available} Schedule B objectives.
- Withdrawals are made only for projects represented by open Schedule B objectives. Check start and completion dates, amounts, remaining basis. Amend Schedule B's if necessary.
- The period of time covered by a single Schedule B project does not exceed 18 months (except for mortgage principal payments related to a specific Schedule B objective).
- Schedule B objectives are to be submitted *prior* to beginning a project. The effective date of a Schedule B objective is the date we receive it. Also request permission to withdraw funds. Withdrawals made prior to these submissions are subject to our ratification and are at risk of being declared nonqualified. (See ratification procedures under CFR 259.33(d) and UPDATE 96-1, p. 5.)

TAX BASIS SCHEDULE

All withdrawal letters currently issued request a schedule showing computation of tax basis. This schedule should show, year-by-year, all vessel costs and all basis reductions to date for withdrawals of tax deferred CCF funds and depreciation. This schedule is necessary in order to verify that there is basis left in each vessel to allow further depreciation or qualified withdrawals. It should show remaining tax basis, if any, as of the end of that particular objective. Please note that copying depreciation schedules from the Agreement holder's tax return is not acceptable unless it clearly shows the vessel's original cost and its current remaining tax basis.

1995 REPORTS ARE NOW DELINQUENT

If tax year **1995** NOAA Form 34-82 and its supporting tax return are not received by April 20, 1997, we will report the case to the Internal Revenue Service as a non-reporter. Also, please note that **1996 reports** are due 30 days after the due date of your 1996 tax return, including extensions.

CONDITIONAL FISHERY REQUIREMENTS REMOVED

You may now disregard all Conditional Fishery Requirements (50 CFR sec 259. 32) for CCF objectives.

REPORTING CCF INFORMATION FROM PASS-THROUGH ENTITIES

Per IRS instructions, partnerships, S-Corporations, and LLCs must now separately state CCF activity to their owners on the K-1. This requirement has caused some confusion in reporting to NOAA Fisheries because we must distinguish whether cash was deposited in the individual agreement holder-s CCF depository, or if the deposit was made in the pass-through entity-s depository under its own agreement.

When CCF deposit activity is shown on a Schedule K-1, the individual taxpayer receiving the K-1 reduces taxable income on Form 1040 at page 2, line 37 for the deposit made by the pass-through entity in addition to the adjustment made for his/her own agreement activity.

For each agreement, we must reconcile each year-s tax return to NOAA Form 34-82. You must furnish us with additional information when the two do not agree. Each NOAA Form 34-82 should only display transactions (including transfers) that affect its own depository. Any other CCF reduction of taxable income for activity of a pass-through entity should be supported by a schedule attached to the tax return and to NOAA Form 34-82. Also, please furnish a copy of each Schedule K-1 showing CCF activity and any CCF related adjustments made between the K-1 and your tax return.

RECURRING ERRORS FOUND ON DEPOSIT/WITHDRAWAL REPORTS (FORM 34-82)

Balance Carried Forward - The balance carried forward from the prior year does not agree with the beginning balance of the current year.

Tax Return Does Not Agree with D/W Report - Deferred taxable income shown in your tax return do not agree with NOAA Form 34-82 transactions.

Unrealized Gains and Losses - Reports should not include any unrealized gains and losses. CCF depository balances must only represent actual deposits, actual withdrawals made during the calendar year, and current year fund earnings redeposited (i.e., not withdrawn). Yearly market value changes for mutual fund investments should not be included.

Schedule A - Identify source of income of your vessel income deposits. Please identify which Schedule A vessel supplied this income. Your agreement and amendments will show these vessels as Schedule A, Page [#]. Also include the name of the vessel in the description area.

Example: 10/1/96 A1996 Income deposit from F/V Dorothy@ A-3

Schedule B - Identify the Schedule B objective for which withdrawal(s) were made. Also add the vessel name, a description and the type of objective (acquisition, construction, reconstruction or mortgage payments).

Examples: 10/15/96 AMortgage payments on F/V Dorothy@ B-4

11/1/96 AReconstruction of F/V Dorothy@ B-5

Signature & Date - All Deposit/Withdrawal reports must bear the original signature of the Agreement holder or currently authorized representative. The date is also required. Your signature certifies that NOAA Form 34-82 reflects true and complete statements of depository activity. If a report is received without a certifying signature, it will be returned for signature.

MOVED... SAME TELEPHONE NUMBER; DIFFERENT EXTENSIONS

As of March 11, we completed the first of two scheduled moves within the A1315" building. For overnight mail, you may wish to direct items to the 15th floor for the next few months. We hope to be settled on the 13th floor late in 1997. For regular mail, use our new mail code F/SF2 in the address. Our complete address is shown below. Our telephone number and FAX number did **not** change:

Voice: (301) 713-2393

FAX: (301) 589-2686

But our telephone *extension* numbers did change. See the enclosed blue sheet listing new CCF staff responsibilities and the new extension numbers. (Hopefully, extension numbers will not change again with the final move.)

NEW EXT.

139	Mary Ellen McMillin
138	Liz Brown
182	Rick VanGorder
174	Tim Gaughenbaugh (Tim takes calls until 5:15 pm)
173	Debbie Richardson (also for general program support)

Steven Schumacher can be reached only through his TDD number. Please refer to the blue sheet for instructions.

Also, please use the following address format change to expedite regular mail delivery:

CCF Program
Financial Services Division (F/SF2)
NOAA/National Marine Fisheries Service
1315 East-West Highway
Silver Spring, MD 20910-3282

MARCH 1997